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No. 82-1760

# In the Supreme Court of the United States

OCTOBER TERM, 1982

HEALTH CARE PLAN OF NEW JERSEY, INC., ETC.,
PETITIONER

*v.*

MARGARET M. HECKLER, SECRETARY OF HEALTH
AND HUMAN SERVICES, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

## MEMORANDUM FOR THE FEDERAL RESPONDENT IN OPPOSITION

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Petitioner, a New Jersey health maintenance organization ("HMO") and a provider of services under the Medicare program, contends that certain New Jersey regulations setting reimbursement rates for hospital services (N.J. Admin. Code tit. 8, §31B-1.1 *et seq.* (Supp. 1980)) are preempted by the Health Maintenance Organization Act of 1973 ("HMO Act"), 42 U.S.C. (& Supp. V) 300e to 300e-17, and the National Health Planning and Resources Development Act of 1974 ("NHPRD Act"), 42 U.S.C. (& Supp. V) 300k-300n.

1. Petitioner is organized and operated as an HMO pursuant to the New Jersey Health Maintenance Organization Act, N.J. Stat. Ann. §26:2J-1 *et seq* (West Cum. Supp. 1982-83). In 1976, petitioner became a federally qualified HMO pursuant to the HMO Act (Pet. App. 9). Federal qualification may be obtained by satisfying the Secretary of

Health and Human Services that an HMO meets federal standards for financial viability (42 U.S.C. (& Supp. V) 300e-5), as well as other requirements (see 42 U.S.C. (& Supp. V) 300e to 300e-17).

In 1978, New Jersey enacted a statute (1978 N.J. Sess. Laws 445 amending the Health Care Facilities Planning Act, N.J. Stat. Ann. §26:2H-1 *et seq.* (West Cum. Supp. 1982-83)) providing for the establishment of a comprehensive system of regulatory control over reimbursement rates for hospital services (Pet. App. 11). In regulations implementing this statute, the New Jersey Department of Health used a new system of Diagnostic Related Groupings ("DRGs") as the basis for reimbursement. This system required hospitals to bill based on the diagnosis of the patient's illness, rather than on the per diem basis formerly used (Pet. App. 12-14). In addition to financing development of the DRG methodology, the federal government agreed to pay DRG hospital rates for its Medicare program pursuant to a waiver of standard Medicare reimbursement principles. 42 U.S.C. (Supp. V) 1395b-1(b).

The DRG system resulted in an increase in the amount petitioner paid to hospitals on behalf of its subscribers (Pet. App. 17). As an HMO, petitioner had tried through preventive health care, preadmission testing, and early discharge to reduce the length of time its subscribers spent in hospitals, thereby reducing the *per diem* charges under the old system (Pet. App. 14-17).

In April 1980, the Secretary notified petitioner that it was not in compliance with the financial standards for federally qualified HMOs (Pet. App. 18-19). When the Secretary subsequently denied petitioner's request to declare it in compliance, petitioner brought suit against the Secretary, the New Jersey Department of Health, and the New Jersey Hospital Rate Commission, in the United States District Court for the District of New Jersey. Petitioner sought an

injunction prohibiting continued enforcement of the New Jersey hospital rate regulations, as well as an order compelling the Secretary to declare petitioner in compliance with the financial viability requirement applicable to federally qualified HMOs. See 42 U.S.C. (& Supp. V) 300e-5.

Following a trial, the district court entered judgment for respondents (Pet. App. 3-35). The court held that the New Jersey DRG program was not preempted either because of a conflict with any federal statute or because the state program interfered with the operation of the federal program regarding HMOs embodied in the HMO Act and the NHPRD Act (Pet. App. 21-35). The court of appeals affirmed without opinion (Pet. App. 1-2).

2a. Insofar as petitioner originally sought an order directing the Secretary to declare petitioner in compliance with federal HMO qualifications, that aspect of the suit is now moot. In January 1982 (prior to the district court's decision), the Secretary issued the requested declaration (Pet. 21).

b. The remaining issue raised by petitioner—whether New Jersey's hospital rate regulations, as applied to petitioner, are preempted by the HMO and the NHPRD Acts—lacks substantial prospective importance because recent passage of the Social Security Amendments of 1983, Pub. L. No. 98-21, §601(c), 97 Stat. 150 (to be codified at 42 U.S.C. 1395), is likely to result in amendment of the New Jersey regulations to allow HMOs to negotiate rates directly with hospitals. Accordingly, further review of this issue is unwarranted.

When petitioner brought this action, the Secretary had waived the usual Medicare reimbursement regulations to allow reimbursement in New Jersey in accordance with the DRG system. On October 8, 1982, the Secretary issued a Statement of Policy requiring future state applications for a

Medicare waiver under 42 U.S.C. (Supp. V) 1395b-1(b) relating to state DRG laws not to "preclude HMOs from negotiating their own rates" with hospitals. 47 Fed. Reg. 44613, 44614 (1982). For states such as New Jersey that already have and wish to maintain a federal waiver for DRG programs, Congress enacted legislation permitting continuation of the waiver only if the state exempts HMOs from the state DRG program. Social Security Amendments of 1983, Pub. L. No. 98-21, §601(c) 97 Stat. 150. Because of the substantial financial incentive afforded by Medicare reimbursement, it is reasonable to expect that New Jersey will amend its DRG system and exempt HMOs. See N.J. Br. in Opp. 4-5 n.*.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
*Solicitor General*

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